EXECUTIVE COMPENSATION: TRENDS, STATUS AND DETERMINANTS

-A Study With Reference to Selected Industrial Units in Karnataka

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INTRODUCTION

Human Resource Management is the process of planning, organising, directing and controlling of the procurement, development, compensation, maintenance, integration and separation of the human resources to the end that individual, organisational and societal objectives are effectively and efficiently accomplished. In this context, SHRM focuses on long-term survival, growth and corporate excellence by achieving 'best fit' internally, vertically, horizontally and externally. "Internal fit" refers to effective synchronisation of various HRM functions right from ‘recruitment to retirement' of employees by shaping and re-shaping the "5 Ps" of human resource management (HR philosophy, policies, processes, programmes, practices). "Vertical fitness" implies meaningful integration of corporate "5 Ps” (corporate philosophy, policies, processes, programmes, practices) with those of "5Ps" of HRM through a 'cascade approach' flowing from top to bottom. "Horizontal fitness" is the process of bringing about a smooth integration of "5 Ps" of HRM with "5 Ps" of other functional areas such as production, finance and marketing in the organisation. Finally, bench marking of the 'best HR practices' by comparing the firm's HR practices with those of the 'best firm' in the industry achieves "external fitness". In the fitness of things, 'compensation management' is one of the integral components of SHRM in any organisation, and as such, it is expected to be managed strategically by achieving the aforementioned internal, vertical, horizontal and external alignment with a long-term focus.

Compensation management is being viewed as a powerful tool to attract and retain talented employees. As a matter of fact, the payroll administration will have a tremendous impact on employees' motivation, performance and satisfaction (MPS). Even though, 'money' is not the 'be all' and 'end all' of human existence, money definitely motivates people at work. Hence, compensation management has got powerful leveraging effect on 'performance management'. Furthermore, employees' perceptions about key issues, dimensions and strategies of executive compensation will

definitely influence their job-related attitudes (job satisfaction, job involvement, turnover intention, and organisation commitment) and workplace behaviour.

The existing literature on compensation administration (base salary, additional allowances, incentives, benefits) in general and 'executive compensation' in particular has left daunting questions unanswered. Compensation for executives has become a major concern to those who are involved with the issue of corporate governance. The level of executive pay and its relationship to corporate performance are now salient issues in the national debate over executive compensation. This trend appears to have generated unprecedented interest and commitment in the academic and practitioner circles to dig deeper into the shell of the trends, status and determinants of executive compensation in India and abroad.

CONCEPTUAL FRAMEWORK

For the purpose of the current research study, the term “Executive Compensation” refers to all forms of financial returns and tangible services and benefits top managers and executives receive as part of an employment relationship.

The 'salary and benefits administration' should systematically and scientifically determine the "pay packages" for operational level employees, supervisors, junior level managers, middle level managers and senior level managers including chief executive officers (CEOs). Pay package should also address the technicalities and challenges involved in determining the nature and magnitude of base salary, additional allowances, incentives and fringe benefits (perquisites). In the right earnest, compensation administration should be based on a sound theoretical grounding, ideological underpinnings and a holistic context of the organisation.

Pay system should translate the compensation strategy into practice in order to achieve the basic objectives of 'efficiency', 'fairness', and 'compliance' with laws and regulations. ***Efficiency*** can be stated more specifically in the following two ways: (1) improving performance, increasing quality, delighting customers and shareholders, and

(2) controlling labour cost. The ***fairness*** objective calls for treatment of all employees by recognising both employee contributions (*e.g.***,** higher pay for greater performance, experience, or training) and employee needs (*e.g.***,** a fair wage as well as fair procedures). This involves 'distributive justice' (what is paid) and 'procedural justice' (how pay is disbursed). ***Compliance*** as a pay objective means conforming to wage laws and regulations. If they change, pay systems may need to be adjusted to ensure continued compliance.

Every employer must address the compensation policy decisions concerning (1) internal alignment, (2) external competitiveness, (3) employee contributions, and (4) management of the pay system. 'Internal alignment' refers to comparision among jobs or skill levels inside a single organisation. Pay relationships within the organsiation affect all three compensation objectives and also employees' motivation, performance and satisfaction levels. 'External competitiveness' refers to compensation relationships external to the organisation (comparison with competitors). Increasingly, an organisation's pay systems are market-driven by basing the decisions almost exclusively on what competitors pay (how much and what forms).

As a matter of fact, executive compensation refers to compensation (salary, incentives, benefits and perquisites) paid to the top-level executives including the CEO. Compared to other employees in the organisation, the executives belonged to a ‘special group’ deserving special treatment either in the form of add-on packages not received by other employees or in the form of compensation components entirely unique in the organisation. As a special group, they share two characteristics. First, they tend to be strategically important to the company. If they do not succeed at their jobs, success for the whole organisation is in jeopardy. Second, their positions tend to have built-in conflict, conflict that arises because different fractions place incompatible demands on members of the group. As such, all executives have jobs with high potential for conflict and resolution of this conflict is central to the goals of the organisation. Probably because of these distinct characteristics, executives receive compensation treatment that differs from the approach for other employees. Unfortunately, most of this

compensation differentiation is prescriptive in nature, and little is known about the specific roles assumed by executives and the functions compensation should assume in motivating appropriate performance.

There are five basic elements of most executive compensation packages: (1) base salary, (2) short-term (annual) incentives or bonuses, (3) long-term incentives and capital appreciation plans, (4) employee benefits, and (5) perquisites. Because of the changing nature of tax legislation, each of these at one time or another has received considerable attention in designing executive compensation packages.

Base salary: Although formalised job evaluation still plays an occasional role in determining executive base pay, other sources are much more important. Particularly important is the opinion of a compensation committee, composed of the company's board of directors or a subset of the board. Frequently all the compensation committee will take over some of the data analysis tasks previously performed by the chief personnel officer, even going so far as to analyse salary survey data and performance records for executives of comparably-sized firms. One empirical study suggests the most common approach (60 per cent of the cases) of executive compensation committees is to identify major competitors and set the CEO's compensation at a level between the best and worst of these comparison groups.

Bonuses: Annual bonuses often play a major role in executive compensation and are primarily designed to motivate better performance. Most striking is the rapid rise in popularity of this type of compensation. Only 25 years ago just 36 per cent of companies gave annual bonuses. Today bonuses are given to 90 per cent executives.

Long-term Incentives and Capital Appreciation Plans: Long-term incentives now account for over one-half of total executive compensation, up from 28 per cent a decade ago. By far the most common long-term incentive remains the executive stock option. A stock option is the right (not obligation) to purchase a stated quantity of stock at a stipulated price (strike price) over a given period of time (exercise period) following certain eligibility (vesting) requirement. Because many of the highest-

reported executive pay packages can be traced to stock options, critics have focused on their use and abuse. One clear complaint is that stock options don't pay for performance of the executive. In a stock market that is rising in all fronts, executives can exercise options at much higher prices than the initial grant price – and the payouts are more likely attributed to general market increases than to any specific action by the executive. Efforts to counter such undeserved rewards are linked to the rise of other types of long-term incentives, some of which require that the executive "beat the market" or hit certain performance targets specifically linked to firm performance. Clearly, in today's more turbulent stock market, stock options are not the "mother lode" they were in the 1990s. Options granted at one price quickly become poor motivational tools when the stock price drops far below that figure.

Executive Benefits: Since many benefits are tied to income level (*e.g.,* life insurance, disability insurance, pension plans), executives typically receive higher benefits than most other exempt employees.

Executive Perquisites: Perquisites or "perks" probably have the same genesis as the expression "rank has its privileges". Indeed, life at the top has its rewards, designed to satisfy several types of executive needs. One type of perk can be classified as internal, providing a little something extra while the executive is inside the company: a luxury office, an executive dining room, special parking. A second category comprises perks that are also company-related but are designed for business conducted externally: company-paid membership in clubs/associations and payment of hotel, resort, airplane, and auto expenses.

The final category of perquisites should be totally isolated from the first two because of its different tax status. This category, called personal perks, includes such things as low-cost loans, personal and legal counseling, free home repairs and improvements, personal use of company property, and expenses for vacation homes.

'Executive compensation programme design' is a significant function of SHRM because of its direct influence on organisation strategy, employees' behaviours, and firm's performance. Researchers across several disciplines have sought to explain the significant levels of executive compensation, their determinants, and their consequences. Empirical studies of executive compensation have been conducted over at least the last 70 years. Meanwhile, executive compensation has emerged as a topic of societal, public policy, and corporate governance significance and accordingly, the audience for the research has grown to include corporate management and boards, investors and the popular business press. The theories that currently receive the most attention, although not necessarily popularly known as such include: marginal productivity theory, governance theories, theories of managerialism and agency theory, structural theory, human capital theory, the symbolism theories of tournament winnings and political strategist appointments. A thumb-nail sketch relating to the theoretical background of executive compensation is provided in chapter- II.

REVIEW OF LITERATURE

The review of literature pertaining to executive compensation research is organised into two main categories: (1) relationship between pay and performance and (2) relationship among pay and behaviors. Traditionally, executive compensation scholars have focused most heavily on the relationships between pay and performance (Finkelstein & Hambrick, 1996). However, because scholarly interest in the behavioural consequences of compensation has grown significantly, over the past decade a substantial amount of executive compensation research has occurred within both categories. Therefore, the researcher further organised the literature in each main category into two subcategories (for a total of four), with one set containing work examining the determinants of compensation and the other containing work examining the consequences of compensation (Exhibit-1.1).

The review suggests that although research is concurrently occurring within the four categories as identified, these categories remain almost completely disconnected.

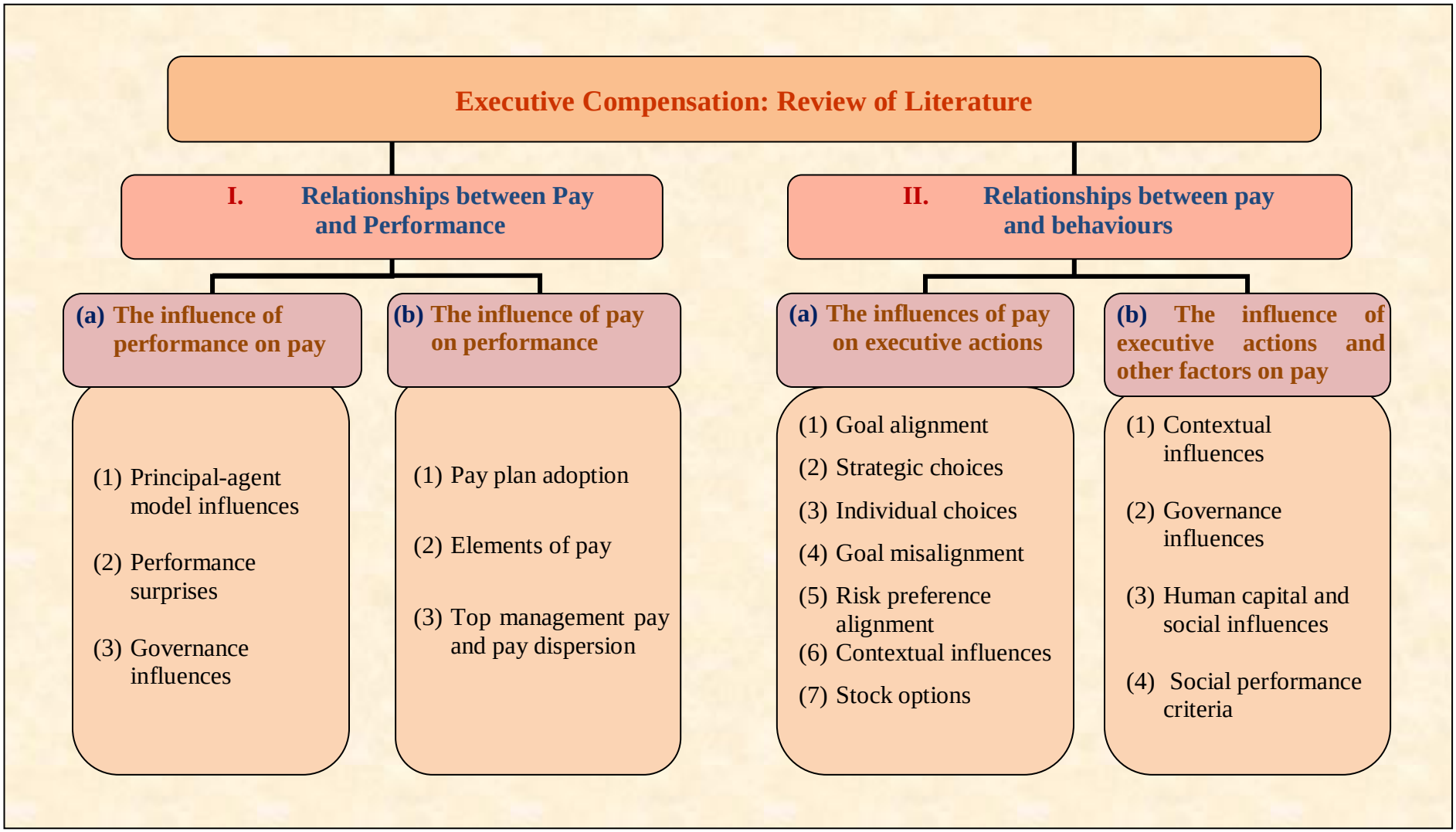
As a result, the researcher found a strong bias towards independence across and within the relationships under study and the disciplines drawn on. With the exception of the few studies examined above, the researcher found scant attention focusing on integrating research findings across categories. Even less work has attempted to integrate findings within categories. Gomez-Mejia and Wiseman (1997) argued that many of the problems they noted in executive compensation research had resulted from a narrow focus that failed to incorporate other theoretical perspectives and methodologies. In contrast, the researcher found recent work so expansive in its approaches that one's ability to draw meaningful conclusions was severely limited.

The review also revealed that the majority of executives' compensation research emanates from the management and finance areas. However, although scholars in these disciplines Cannella, & Lubatkin (2005). For example, developing, extending and testing theoretical logic is fundamental to management research. On the other hand, empirical regularity, rigor, and sensitivity analyses are principal to finance research. Given these extremes, it is not surprising that cross discipline integration is rare. It is clear that there is still much to be learned about executive compensation, thus, it is believed that cross-discipline integration holds the potential significantly advance compensation research and practice. Accordingly, compensation scholars should recognise and incorporate the contributions and insights from other disciplines in their work.

Furthermore, and perhaps more troubling, the review revealed that compensation research broadly suffers from a number of conceptual and methodological issues. For example, there is little consistency in the operationalisation of many important constructs of interest. Particularly troubling was the use of ambiguous or inconsistent measures of firm performance compensation, and risk (both action risk and perceptual risk). Also found the selection criteria for sample frames, time lags, covariates and statistical methodologies to be wide ranging. It is observed that the broad, disconnected nature of the field, coupled with the conceptual and methodological heterogeneity noted above continues to constrain the advancement of

executive compensation research. Nevertheless, it also presents a mixed blessing. Specifically, many questions remain unanswered, limiting our understanding of the determinants and consequences of executive compensation. At the same time, the many unanswered questions offer compensation scholars extremely fertile research opportunities. A critical review of previous research studies pertaining to the current field of investigation is presented in chapter-III.

Exhibit 1.1: Review of Literature: A brief description of each study


Executive Compensation: Review of Literature
I. Relationships between Pay and Performance
II. Relationships between pay and behaviours
(a) The influence of performance on pay
(b) The influence of pay on performance
(a) The influences of pay on executive actions
(b) The influence of executive actions and other factors on pay
(1) Principal-agent model influences
(2) Performance surprises
(3) Governance influences
(1) Pay plan adoption
(2) Elements of pay
(3) Top management pay and pay dispersion
(1) Goal alignment
(2) Strategic choices
(3) Individual choices
(4) Goal misalignment
(5) Risk preference alignment
(6) Contextual influences
(7) Stock options
(1) Contextual influences
(2) Governance influences
(3) Human capital and social influences
(4) Social performance criteria

CONCEPTUAL FRAMEWORK GUIDING THE PRESENT RESEARCH STUDY

Based on the conceptual, theoretical and empirical review of literature pertaining to the current field of investigation, an attempt is made to outline the conceptual framework (roadmap) guiding the present research study (Exhibit 1.2). In tune with the systems approach, the blueprint of the study comprised four subsystems: (a) inputs, (b) transformation process, (c) output, and (d) outcome.

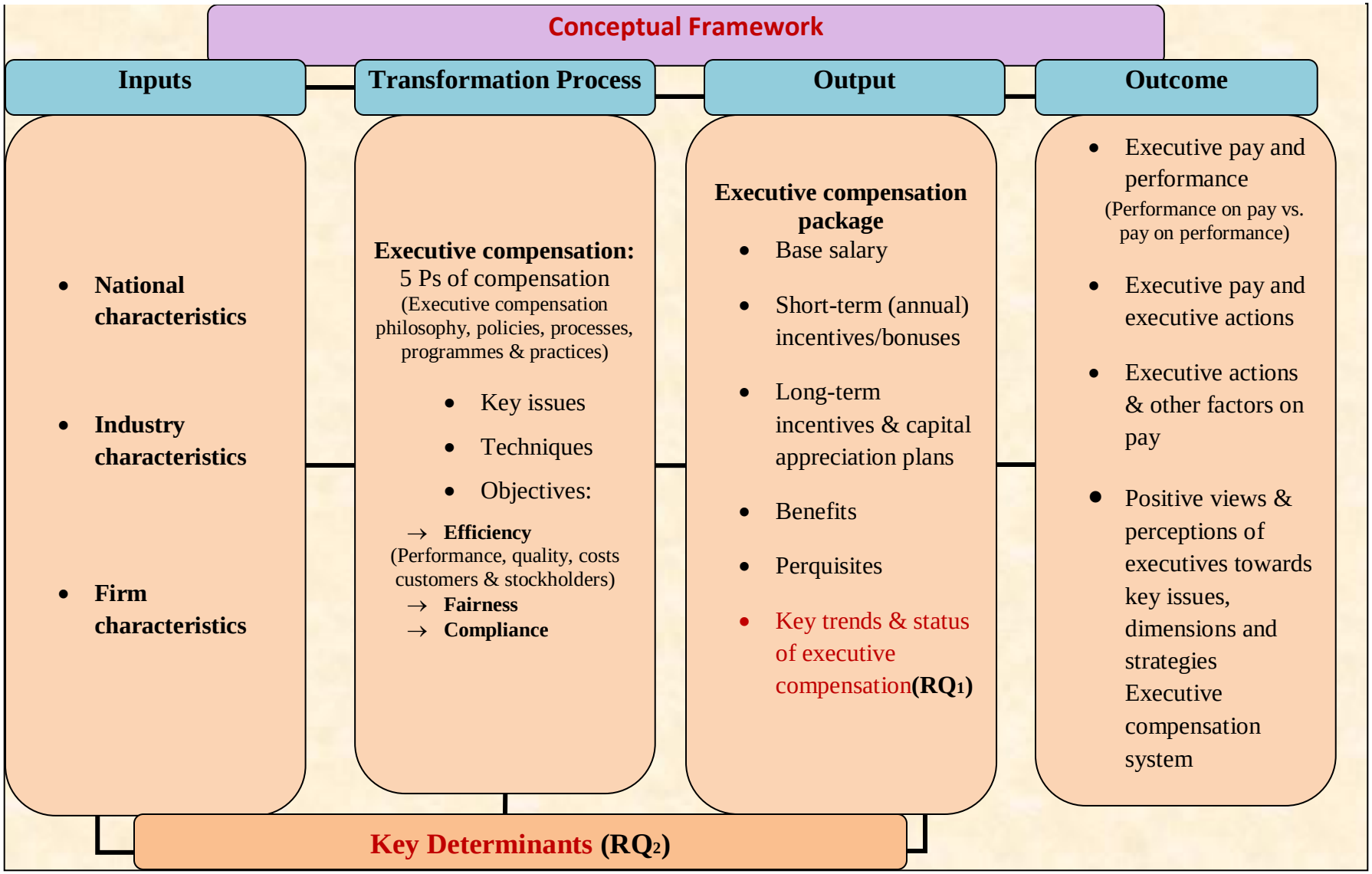
The prominent inputs which are known to exert influence on the executive compensation systems are: national characteristics (cross-national/cross-cultural differences), industry characteristics (industry differences), and the characteristics of individual firms (ownership pattern, nature of main activity, workforce size, age of the establishment, scale of investment, ISO accreditation status, scale of operations, industry category, stage of the organisational life cycle). According to the systems approach, inputs will be transformed into expected output through the efficiency and effectiveness of the 'transformation processes'.

The transformation process will have to handle the dynamics of the five-Ps of executive compensation (compensation philosophy, policies, processes, programmes & practices), key issues, techniques, strategies and triple objective of executive compensation such as efficiency, fairness and legal compliance. Apparently, the expected output will be in the form of a tailor-made executive compensation package consisting of base salary, short-term (annual) incentives or bonuses, long-term incentives and capital appreciation plans, benefits and perquisites. Besides this the key trends and status of executive compensation in the area covered by this study will be highlighted.

In the fitness of the things, the last component of this conceptual framework is the intended outcome of designing and implementing a specific executive compensation package in the form of executive pay and performance relationship, the

relationship between executive pay and executive actions (executive behaviour), relationship between executive actions and other factors on pay and finally positive views and perceptions of the executives on five P's of executive compensation system. In the end, as a feedback loop, the inputs and transformation process are known to individually and jointly determine the nature of executive compensation package and its associated intended and unintended consequences**.**

EXHIBIT 1.2: Conceptual Framework Guiding the Present Research Study


Conceptual Framework
Inputs
Transformation Process
Output
Outcome
National characteristics
Industry characteristics
Firm characteristics
Executive compensation: 5 Ps of compensation (Executive compensation philosophy, policies, processes, programmes & practices)
Key issues
Techniques
Objectives:
→ Efficiency (Performance, quality, costs customers & stockholders)
→ Fairness
→ Compliance
Executive compensation package
Base salary
Short-term (annual) incentives/bonuses
Long-term incentives & capital appreciation plans
Benefits
Perquisites
Key trends & status of executive compensation (RQ1)
Executive pay and performance (Performance on pay vs. pay on performance)
Executive pay and executive actions
Executive actions & other factors on pay
Positive views & perceptions of executives towards key issues, dimensions and strategies Executive compensation system
Key Determinants (RQ2)

STATEMENT OF THE RESEARCH PROBLEM AND RESEARCH QUESTIONS

It is worth noting that executives are highly paid in the Indian corporate sector and at times, lofty executive pay packages have become the subject of public scrutiny and outrage. Pay attention to the way of granting stock options has gradually played a bigger role in executive compensation. Many critics argue that this level of managerial and executive compensation is excessive. Are the critics right? One way to answer the question is to look at the different ways in which executive compensation is determined and ask, “does this seem reasonable”?

There is a general consensus in the academic and practitioner circles that compensation systems can help an organisation achieve and sustain competitive advantage (E Lawler III 2000). The researchers and practitioners are very much concerned with a conceptually sound, logically consistent and operationally viable framework for examining the current executive pay systems, policies, techniques, and programmes. Such a framework is expected to contain three basic building blocks: (1) the objectives of executive compensation (2) the policies that constitute a foundation for the executive compensation system, and (3) the techniques that make up the executive compensation system.

Indian corporate sector has been struggling hard to attract and retain talented pool of top managers and executives by effectively handling strategic devices pertaining to executive compensation. This calls for an evidence-based and well-researched framework addressing the following components (1) what business should we be in? (corporate objectives, strategic plans, vision, and values), (2) how do we win (aim competitive advantage) in those business? (business unit strategies), (3) how should HR help us win? (HR strategies), (4) how should total compensation, including executive compensation help us win? (social, competitive and regulatory environment; strategic compensation decisions; compensation systems; employee attitudes and behaviour; and competitive advantage).

A currently popular theory found in almost every book and consultant's report tells managers to tailor their pay systems to align with the organisation's business strategy. The rationale is based on contingency notions. That is, differences in firm's strategy should be supported by corresponding differences in its human resource strategy, including compensation. The underlying premise is that the greater the alignment, or fit, between the ***organisation*** and ***the compensation system***, the more effective the organisation. Strategy refers to the fundamental directions that an organisation has chosen. An organisation defines its strategy through the tradeoffs it makes in choosing what (and what not) to do.

In this context a strategic perspective of executive compensation should focus on those compensation choices that help the organisation earn and sustain competitive advantage. Being an under-researched area, academicians and practitioners should focus on the following five dimensions of executive compensation:

(1) How should executive compensation support the business strategy and be adaptive to the cultural and regulatory pressures in a global environment?

(2) How differently should the different types and levels of skills and work of executives be paid within the organisation?

(3) How should total executive compensation be positioned against competition?

(4) Should pay increases of executives be based on individual and/or team performance, on experience and/or continuous learning, on improved skills, on changes in cost of living, on personal needs (housing, transportation, health services), and/or on business unit's performance?

(5) How open and transparent should the pay decisions be to all executives? Who should be involved in designing and managing the executive pay system?

The decisions underlying these five issues, taken together, form a pattern that becomes an organisation's executive compensation strategy.

This research study titled "Executive Compensation: Trends, Status and Determinants – A Study with reference to selected industrial units in Karnataka" intends to answer the following two research questions:

Research Question (RQ)-1: What are the broad trends and status of executive compensation in Karnataka?

Research Question (RQ)-2: What are the key determinants of executive compensation in Karnataka?

OBJECTIVES

The central purpose of this research study is to examine and report on the trends, status and determinants of executive compensation in Karnataka.

The specific research objectives include the following:

(1) to analyse and describe a macro industry-level perspective of executive compensation in India;

(2) to examine and discuss the key trends and status of executive compensation programmes in Karnataka;

(3) to elicit and report on the views and perceptions of the executives about the key issues, dimensions and strategies of executive compensation in their respective organizations;

(4) to identify and discuss the key determinants of executive compensation strategies and decisions; and

(5) to raise major implications for theory, research and practice of executive compensation based on the findings of this research study.

HYPOTHESES

Based on the extensive review of literature, the following research hypotheses have been formulated for further investigation in this research study:

- **H_1 (a)**: There exists a significant positive correlation between sales volume (firm size) and executive compensation over a period of five years across different industrial sectors.

- **H_1 (b)**: There exists a significant positive correlation between net profit (firm performance) and executive compensation over a period of five years across different industrial sectors.

- **H_2**: Sales volume (firm size) and net profit (firm performance) tend to determine the executive compensation in different industrial sectors.

- **H_3 (a)**: Intention to increase the executive pay during the next two years tends to differ across organisations based on their diverse organisational characteristics.

- **H_3 (b)**: The percentage of pay hike during the next two years tends to differ across organisations based on their diverse organisational characteristics.

RESEARCH METHODOLOGY

This research study is partly analytical and partly explanatory in nature. The thesis is developed mainly based on primary data and information collected through a postal questionnaire from the respondent industrial units in Karnataka. However, the secondary sources such as books, periodicals, published annual reports of listed companies in Bombay Stock Exchange directory were consulted with a view to finalising the conceptual and theoretical framework, review of literature (conceptual and empirical), a macro perspective of executive compensation representing different industrial sectors in India, and drafting the preliminary questionnaire.

In order to highlight the broad trends and status of executive compensation and the proportion of variable compensation in total remuneration paid to executives on an all-India basis (macro perspective), one hundred and seven companies listed in Bombay Stock Exchange directory were chosen through purposive sampling. The relevant secondary data and information for five years (2005-06 to 2009-10) about one hundred and seven companies pertaining to executive compensation, sales volume, and net profit were collected from the published annual reports of the sample companies.

As far as the survey-based (quantitative) research was concerned, the directory of Confederation of Indian Industry (CII-Karnataka chapter) 2007 served as the database containing 2431 Listed companies. A comprehensive, structured and pre-tested questionnaire was mailed to 642 industrial units in Karnataka fairly and adequately representing large scale private, public and multi-national enterprises engaged in manufacturing and/ or service operations in May 2008. A disproportionate stratified random sampling technique was used to choose different categories of respondent industrial units in the area covered by this study. The respondents were Human Resource Managers/Payroll Administrators who could answer the questions contained in the questionnaire about executive compensation system and practices on behalf of the organisation at the establishment level. After three months of mailing the questionnaires, 134 filled-in questionnaires were received with a gross response rate of 20.9 per cent. As a follow-up measure, reminders were sent through E-mail/telephone/letters to 508 non-respondents. As a result, additional 172 filled-in questionnaires were received during the following four months with an additional response rate of 26.8 per cent. After carefully editing 306 questionnaires, 59 questionnaires were rejected on account of incorrect filling/non-filling of questionnaires, thereby rendering only 247 filled-in questionnaires for further processing, yielding an effective response rate of 38.5 per cent.

Based on an extensive review of literature and "focus group interview" with five top level executives representing a cross-section of industrial units in Bangalore, the draft questionnaire was prepared. In the fitness of things, this draft questionnaire was administered to 31 executives in and around Bangalore with a view to pre-testing the structure, wording and sequencing of the questions contained in the questionnaire. After obtaining proper and adequate insights from this pilot study, the final questionnaire was ready for mailing. As far as the structure and contents of the final questionnaire were concerned, there were three parts: Part-A (organisational characteristics), Part-B (trends and status in executive compensation), and Part-C (views and perceptions about executive compensation system and practices). Part –A consisted of eight questions, Part-B contained seven questions and Part-C included 52 perceptual statements on ***Likert's*** *5-point agree-disagree response format*. Appropriate statistical tools and techniques such as percentages, mean and standard deviation, Garrets ranking technique, chi-square test, Kruskal Wallis test, multiple correlations, ANOVA, and multiple regression analysis were used to analyse and interpret the quantitative sample survey data. Interesting and inferential survey data and information were also projected in the form of figures, charts, and diagram.

SCOPE AND LIMITATIONS

This research study is confined only to select large scale industrial units in Karnataka and the small and medium enterprises (SMEs) were excluded from the purview of this study. In fact, the study concentrated on measuring and assessing the trends, status and determinants of executive compensation comprising top level executives including CEO in order to conduct an in-depth analysis of executive compensation strategies and practices in Karnataka. Accordingly, wage and salary administration concerning operational level employees, junior and middle level managers were also kept outside the scope of this study. Because of this 'micro' nature of the study, the inferences and conclusions drawn from the field survey data could not be generalised so as to make them applicable to SMEs or large scale industrial units in other states due to inter-industry and cross-cultural differences.

Furthermore, only 107 listed companies were considered for the purpose of capturing the macro perspective of executive compensation (variable and non-variable pay) on an all-India basis. Nevertheless, the present research study certainly throws additional light on the trends, status and determinants of executive compensation system and practices in Karnataka by abridging the current research gaps in this domain.

MAJOR FINDINGS

The key results and discussions of this research study are briefly presented in the following sections under three broad categories: (a) Executive compensation: macro perspective, (b) Executive compensation: trends and status in Karnataka, and (c) Executive compensation: key determinants.

(a)Executive Compensation: A Macro Perspective

- Considering all the 20 industrial sectors and 107 companies belonging to these industrial sectors in one basket, executive compensation demonstrated an upward trend over the 5-year reference period (2005-06 to 2009-10) as indicated by the mean values of executive compensation for the respective years: 2006 (2.66), 2007 (3.56), 2008 (4.81), 2009 (5.12), and 2010 (6.74).
- The sector-specific industry trend indicated that inter-sectoral variations prevailed across 20 different industrial sectors. Sector-wise analysis highlighted mixed results pinpointing substantial increase, moderate increase, constant increase, and even a downturn in executive compensation over the reference period.
- Taking into account the overall percentage change in executive compensation, retaining 2006 as the base year, there has been around 218 per cent increase in executive pay in 2010. Here also, the percentage change in executive compensation significantly differed across industrial sectors.
- Considering the total pay, variable pay and percentage of variable pay in the total executive pay over a 3-year reference period (2008-2010 relating to 36 companies chosen through purposive sampling clearly revealed that the

variable pay occupied a substantial proportion in the total executive pay. For instance, five companies reported more than 90 per cent share of variable pay in the total executive pay, namely, Hero Honda, Aditya Birla Ltd., Cipla, Divis Lab and Reliance Industries.

(b) Executive Compensation: Trends and Status in Karnataka

- As far as the profile of the respondent industrial units was concerned, nearly 60 per cent represented the private sector, ten to twenty year old. More than one-half of the units had the workforce size ranging between 100 and 500 employees, and ISO certified. A sizeable proportion of around 79 per cent represented the growth and maturity stages of their organisational life cycle.
- A conducive and congenial working environment has been perceived as a 'key driving force' for attracting talented people to junior manager and middle manager positions, whereas **executive compensation** was figured out as a dominant factor for attracting promising people to the senior-level management positions.
- In addition to the gross emoluments, most of the companies provided medical and health benefits, mobile phones and laptops to their executives. A few companies also offered their executives benefits such as housing support, car loans, overseas training/assignment, employee referral schemes and employee stock option plan (ESOP).
- By and large, the respondents anticipated **pay-hikes** for senior management positions, **reduced pay** for junior managers and predicted **no change** in the pay of middle level managers in the immediate future.
- 'Lack of career growth' was perceived to be the main reason for junior and middle level managers leaving their respective organisations, but in case of senior level managers it was 'lack of timely and appropriate recognition'. Most of the industrial units responding to the sample survey adopted

innovative benefit schemes for retaining executive talents such as sign-on bonus, retention bonus, stock option, skill-based bonuses and overseas assignments.

- Executive compensation system is essentially an integral part of an organisation's performance management system. In fact, as one moves up the organisational ladder, the salary jump sought becomes higher. Respondents endorsed the view that there existed a direct linkage between pay and performance. However, many perceived that the ability of pay to influence the executive performance was doubtful. Furthermore, they also opined that most of the executives in their organisations were comfortable with the idea of variable pay. All said and done, the relationship between pay and performance is definitely interesting and relevant, but extremely elusive and difficult to establish. Most of the respondents endorsed the view that executive compensation was the most important determinant of job satisfaction. They also opined that, since different pay elements had different risk property, each element could exhibit a unique influence on executive behaviour. However, it could be inferred that there may not exist any single, straight-forward and linear relationship **between** executive pay and executive behaviour or vice versa. Most of the respondents firmly believed that executive pay would be influenced by several other factors, such as executive-specific characteristics, market forces and social comparisons.

(c) Executive Compensation: Key determinants

- There existed a statistically significant association **among sales volume, net profit** and **executive compensation** over the 5-year reference period combining all 20 industrial sectors in one bunch as shown by the Kruskal Wallis Test. However, sector-specific analysis indicated inter-sectoral differences in this trend. Further, Pearson's Correlation Coefficient (r)

revealed that out of 20 industrial sectors only 7 sectors had significant positive correlation **between** the 5-year reference period (time) and executive compensation; 10 industrial sectors showed positive significant correlation **between** the sales volume (firm size) and executive compensation; and again 10 sectors exhibited positive significant correlation **between** net profit (firm performance) and executive compensation. In gist, only 3 sectors such as Engineering, FMCG, IT&ITeS indicated positive significant correlation ***between*** time and executive compensation, sales volume **and** executive compensation, and net profit **and** executive compensation. Accordingly, the research hypotheses '**$H_{1(a)}$** and **$H_{1(b)}$**' have been accepted in an aggregate sense (Exhibit-1.3: Summary table).

- Based on the results of multiple regression analysis, changes in sales volume(firm size) and net profit (firm performance) had 18.2 per cent impact on executive compensation ($\boldsymbol{R^2}$ = 0.182). Not surprisingly, inter-sectoral variation in the impact of sales volume and net profit on executive compensation was clearly noted. Finally, compared to sales volume (firm size), **net profit (firm performance)** exerted greater impact on executive compensation. Accordingly, the research hypothesis 'H_2' was also accepted (Exhibit-1.3: Summary table).
- The intention to increase executive pay and the possible percentage hike in executive pay during the next two years significantly differed across companies based on their diverse organisational characteristics such as (i) ownership pattern, (ii) nature of the main activity, (iii) age of the industrial unit, (iv) workforce size, (v) ISO accreditation status, (vi) industrial category, (vii) stage of the organisational life cycle, and (viii) organisational complexity. Accordingly, the research hypotheses '**$H_{3(a)}$** and **$H_{3(b)}$**' have been accepted (Exhibit-1.3: Summary table).

Exhibit – 1.3: Hypothesis testing: Summary

S.No.	Hypothesis	Result	Remarks	Cross- findings
1	**H1 (a)**: There exists a significant positive correlation between sales volume and executive compensation over a period of five years across different industrial sectors.	Kruskal Wallis x^2 = 18.513; d.f= 4; p = .001	**Accepted**	Roberts (1959), Mc Guire, Chiu, and Elbing (1962), Barro and Barrow (1990).
2	H1 (b): There exists a significant positive correlation between net profit and executive compensation over a period of five years across different industrial sectors.	Kruskal Wallis x^2 = 12.573; d.f= 4; p = .014 Over all-x^2= 6.729; d.f= 4; p = .000	**Accepted**	Fama (1980), Jensen and Murphy (1990), Morgan and Poulsen (2001), Ballout Hassan I., (1992).
3	H**2**: Sales volume and net profit tend to determine the executive compensation in different industrial sectors.	ANOVA t - F = 56.695; df = 2; p = 0.000	**Accepted**	Cisal and Caroll (1980), Tosi, Werner, & Gomez- Mejia (1989)
4	H**3** (a): Intention to increase the executive pay during the next two years tends to differ across organisations based on their diverse organizational characteristics.		**Aceepted**	--------
	1. Ownership pattern	(x^2 = 53.93; p = <0.001 HS; d.f = 2; Coeff. = 0.423).		
	2. Nature of main activity	(x^2 = 70.586; p = <0.001- HS; d.f = 1; Coeff = 0.471).		
	3. Age of the Industrial unit based on the year of establishment	(x^2 = 71.28; p = <0.001- HS; d.f = 2; Coeff = 0.473).		
	4. Size of workforce	(x^2 = 22.95; p = <0.001- HS; d.f = 2; Coeff = 0.292).		
	5. ISO accreditation status	(x^2 = 81.48; p = <0.001- HS; d.f =2; Coeff = 0.498).		Contd…

	6. Industrial category	(x^2 = 48.794; p = <0.001- HS; d.f = 7; Coeff = 0.406).		
	7. Stage of organizational life cycle	(x^2 = 99.809; p = <0.001- HS; d.f = 4; Coeff = 0.536).		
	8. Organisational complexity	(x^2 = 70.58; p = <0.001- HS; d.f = 1; Coeff = 0.471).		
5	H**3** (b): The percentage of pay hike during the next two years tends to differ across organisations based on their diverse organisational characteristics.			
	1. Ownership pattern	(Fishers exact test; p = <0.0001- HS; Coeff = 0.723).	**Aceepted**	----------
	2. Nature of main activity	(x^2 = 64.902; p = <0.001- HS; d.f = 3; Coeff = 0.527).		
	3. Age of the Industrial unit based on the year of establishment	(x^2 =114.75; p= <0.0001- HS; d.f = 6; Coeff = 0.636).		
	4. Size of workforce	(Fishers exact test; p = <0.0001- HS; Coeff = 0.554).		
	5. ISO accreditation status	(x^2=113.50; p = <0.0001- HS; d.f = 9; Coeff = 0.501).		
	6. Industrial category	(Fishers exact test; p = 0.029- Sig; Coeff = 0.418).		
	7. Stage of organisational life cycle	(Fishers exact test; p = <0.0001- HS; Coeff = 0.556).		
	8. Organisational complexity	(x^2=72.184; p = <0.0001- HS; d.f = 3; Coeff = 0.547)		

Note: x^2= chi-square, df = degree of freedom, HS = Highly Significant, ANOVA = Analysis of Variance.

IMPLICATIONS

The amount of executive compensation tends to increase over a period of time in an aggregate sense. The nature and magnitude of this change in executive compensation on a longitudinal time-scale are bound to vary across different industrial sectors owing to differences in inter-industry contextual settings. Therefore, the structure, composition, size and strategies of executive pay fixation and revision are **country-specific** and **context-specific** in nature.

The results of this research study clearly indicated significant positive correlation **between** firm size and executive compensation on the one hand and **between** firm performance and executive compensation on the other. Furthermore, even though firm size and firm performance emerged as the key determinants of executive compensation in India, firm performance exhibited a greater impact on executive compensation than the firm size did. It is logically tenable that more than the size of the firm it is the **firm's performance** which would justify the size of the executive pay package.

The main results support the marginal productivity theory which says; 'the size of the executive pay package reflects the firm's net profit". The result of this research study reveals that there is a positive relationship **between** executive compensation and firm performance.

DIRECTIONS FOR FUTURE RESEARCH

There is an imperative need to integrate previous executive compensation theories by specifying variables and examining their joint effects on the structure and process of reward policies pertaining to CEOs and top management. Executive compensation may be determined both by the size of the firm and by the internal social process.

It is also pertinent to examine the relationship among the organisational size, firm performance, industry types, tenure as CEO and executive pay. Controlling for

changes in firm size and changes in shareholder wealth, it is also worth examining the relationship between CEOs compensation and stock performance.

In the fitness of the things, future research should also focus on executive compensation policies and practices in a cross-national context in order to examine the cross-cultural perspectives in determining the structure and composition of CEO reward system.

CEO compensation is more than cash compensation. Although long term compensation is hard to measure across companies and industries, there is a need to apply the framework of this study to examine the long view on executive pay. Long term compensation plans that are tied to long term company performance need to be addressed in future research. Such inquiry may modify the factors linked to incentive rewards. In addition to that, considerable effort is needed to examine the role of compensation committees in relation to pay/performance linkage. Some of the key research questions that need to be addressed in the future include the following: what are the specific factors on which compensation committees base the executives' pay? What is the nature of the relationship **among** members of compensation committees, the CEO, and shareholders when it comes to deciding on incentive rewards?

CONCLUSION

The diversity of results, combined with the intensity of today's debate over executive pay, calls not only for an integrative approach but also for the use of alternative methodologies.

Executive pay and firm performance appear to be simultaneously determined. What is suggested is that the practitioners, business consultants, sociologists, organisational theorists, and others who oppose the current system of executive compensation should reexamine their positions. The real question is not whether executives are paid too much (we know that a minority of executives are overpaid), but rather whether owners are getting their money's worth from their executives.

The received theoretical perspectives are, however, fragmented, providing some insights into the determinants of incentive compensation paid to top executives, or how the industrial corporation that attracts high-caliber executives by paying them a seven to eight digit rupee amount becomes competitive in today's world markets.

There is a link between pay and performance. However, the areas of executive pay needing reform reside in the **process** of determining CEO rewards that are in the hands of corporate boards and compensation committees. CEO compensation has its highest elasticity with respect to social influence. Unfortunately, boards of directors and compensation committee focus more on social industry norms than on corporate growth and firm's competitive behaviour.

The concept of 'pay for performance' has gained wide acceptance, but the link between executive pay and superior performance is still too weak. There might be virtually no link between how much CEOs were paid and how well their companies performed for shareholders. Problems with pay at the top indicate that corporate boards must choose both the **right measures** and the **right levels** of performance. Shareholders will definitely applaud changes in pay schemes that motivate companies to deliver more value. To conclude, managers and human resource professionals must learn from compensation theory, research and practice as to how to weigh the pros and cons of different executive compensation plans and construct a framework for thinking about this important aspect of the struggle to attract and retain executive talent.

CHAPTER CLASSIFICATION

This research study titled "Executive Compensation: Trends, Status and Determinants - A study with reference to selected industrial units in Karnataka" is coordinated in seven chapters as outlined below:

CHAPTER - 1: "INTRODUCTION" is devoted to a clear description of the background of this study, conceptual framework applicable to the study, statement of the research problem and research questions, objectives, research hypotheses and the research methodology. The scope and limitations of this research study and the chapter classification are also detailed in this chapter.

CHAPTER - 2: "THEORETICAL BACKGROUND" examines and discusses the theoretical framework elaborating upon the major variables affecting executive compensation systems, policies and programmes, and the key theoretical propositions underpinning executive compensation strategies and decisions.

CHAPTER - 3: "REVIEW OF LITERATURE" provides a critical review of earlier studies carried out by the researchers in the domain of 'compensation administration' in general and 'executive compensation' in particular in India and abroad.

CHAPTER - 4: "EXECUTIVE COMPENSATION: MACRO PERSPECTIVE" captures a thumb-nail sketch of the broad trends and status of executive compensation and the proportion of variable pay in total remuneration of executives in hundred and seven listed companies representing twenty industrial sectors (BSE classification) on an all-India basis.

CHAPTER - 5: "EXECUTIVE COMPENSATION: TRENDS AND STATUS" discusses and reports on the overall trends and status of executive compensation system and practices in Karnataka based on empirical survey.

CHAPTER - 6: "EXECUTIVE COMPENSATION: KEY DETERMINANTS" highlights and discusses the major factors influencing executive compensation policies and practices in Karnataka. Five research hypothesis formulated in Chapter-I are tested and the results reported in this chapter.

CHAPTER - 7: "SUMMARY AND CONCLUSIONS" provides a capsule summary of the results and discussions presented in the earlier chapters. The major implications for executive compensation system designers and policy makers, and directions for further research are also included in this concluding chapter.

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